



Order Audit Trail System (OATS)

Phase III

OATS Phase II

Phase II of the OATS Rules has been in effect since August 1999 and applies to all electronic orders.

During Phase II, an electronic order is defined as any order captured in an electronic order routing or execution system.

OATS Phase III

On September 28, 2005, the SEC approved SR-NASD-00-23 relating to the OATS Rules.

As approved, the rule amendments:

- Implement the reporting requirements for manual orders (OATS Phase III)
- Provide that members are required to capture and report the time the order is received by the member from the customer for all orders
- Expand the order transmittal requirements to include orders routed to a member's trading desk or trading department
- Exclude certain members from the definition of "Reporting Member"
- Permit NASD to grant exemptive relief from the OATS reporting requirements to members that meet specified criteria

OATS Phase III – Implementation Dates

November 11, 2005: Publication of OATS Reporting Technical Specifications and Notice to Members containing interpretive guidance on the new rule requirements releases.

March 27, 2006: All OATS Phase III changes will be available in the OATS Testing Environment so that firms may begin submitting test data.

May 8, 2006: OATS Phase III requirements effective in the OATS production system. Order events submitted that are not compliant with Phase III technical requirements will be rejected by OATS.

The Implementation Date for OATS Phase III has since been moved to July 10, 2006

OATS Phase III – Manual Orders

OATS Phase III requires that all orders in NASDAQ equity securities be reported to OATS, including:

- Orders received telephonically
- Orders received via email
- Orders received via Internet
- Orders received at branch offices
- Orders received by Instant Messenger

OATS Phase III – Manual Orders

Reporting Requirements for Manual Orders are the same as for Electronic Orders with the following exceptions:

- Routed Order IDs are not required to be captured or passed for manually transmitted orders. Routed Order IDs have been required for orders routed electronically to other members since March 1999 and for orders routed electronically to ECNs since February 14, 2005.
- Account Type Code (e.g., Proprietary, Retail, Wholesale) is required only if available

OATS Phase III – Time of Receipt

During Phase II, the time of receipt for an electronic order is the time an order is captured by a firm's electronic order routing or execution system.

In Phase III, the time of receipt, for both electronic and manual orders, is the time the order is received from the customer.

OATS Phase III – Desk Reports

Because orders may be routed to multiple locations within the firm prior to reaching the trading desk, the order transmittal requirements have been expanded to include intra-firm routes to the trading department.

- A Desk Report will now be required when an order is transmitted to the trading desk or other desk within the firm.
- If the time of receipt from the customer and time of transmittal to the trading desk or other desk within the firm occurs within a second, no separate desk report will be required.
- OATS will not, however, reject desk reports for orders that are received by a desk within a second of the order receipt time.

OATS Phase III – Desk Reports

Desk Report Format Changes

The following fields have been added to the Desk Report:

- Shares Quantity

- Desk Code

Trading (T)	Arbitrage (AR)
Proprietary (PR)	Agency (A)
Sales (S)	Derivatives (D)
Institutional (IS)	Preferred (PF)
Program Trading (PT)	Treasury (TR)
International (IN)	Other (O)

- Desk Special Handling Codes

OATS Phase III – Desk Reports

If an order is routed to another desk in full on the same day as receipt, firms must report the internal route using a New Order event (i.e., New Order Report, Combined Order/Route Report or Combined Order/Execution Report). The following fields have been added to all New Order events:

- Desk Receipt Time
- Desk Code
- Desk Special Handling Codes
- Received By Desk ID

OATS Phase III – Definition of Trading Desk

Trading Desk or Trading Department is intended to refer to the function within the firm that is responsible for executing orders in NASDAQ securities.

This function can include:

- A trading system where orders are executed automatically without trader intervention; or
- The trading department where orders are executed with the assistance of traders.

OATS Phase III –Reporting Member Exclusion and Exemptive Relief



OATS Phase III provides two ways in which certain members may be relieved of complying with the full scope of the OATS Rules.

- The first is an exclusion from the definition of OATS Reporting Member pursuant to NASD Rule 6951(n) that applies to firms with certain business models that result in another member firm reporting essentially the same information to NASD.
 - Exclusion from the definition of OATS Reporting Member relieves a member from the full recording and reporting requirements of the OATS Rules.
 - Does not relieve members from the clock synchronization requirements under NASD Rule 6953.
- The second is a provision that grants NASD exemptive authority in certain limited situations for small members where complying with the full scope of the OATS Rules would be unduly burdensome.
 - Exemptive relief applies only to the transmission requirements of the OATS Rules.

OATS Phase III – Reporting Member Exclusion

The Phase III amendments to the OATS Rules exclude from the definition of Reporting Member firms that:

- Engage in a non-discretionary order routing process where it immediately routes all of its orders to a single receiving Reporting Member
- Do not direct or maintain control over subsequent routing or execution by the Receiving Member
- The receiving Reporting Member records and reports all information under NASD Rules 6954 (recording of order information) and 6955 (reporting of order information)
- Have a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party

OATS Phase III – Reporting Member Exclusion

What does this mean?

Engage in a non-discretionary order routing process where it immediately routes all of its orders to a single receiving Reporting Member.

- If any delay results in the routing of an order due to systems problems or other reasons, the member with which the order originated would be required to report OATS data.
- 100% of the firm's orders must be routed to the same reporting member. If the member accepts and routes an order to another venue, or executes an order internally, that member would be required to report OATS data for all of its orders, including those sent to its clearing firm on a non-discretionary basis.
- If a member conducts non-market making proprietary business and executes a proprietary trade away from the firm's clearing firm, then that member would be required to report OATS data for all of its orders, including those sent to its clearing firm on a non-discretionary basis.

OATS Phase III – Reporting Member Exclusion

Do not direct or maintain control over subsequent routing or execution by the Receiving Member.

- All orders must be entered by the member on a non-discretionary basis into the Receiving Member's system.
- If the Receiving Member's system provides the ability for the member to direct an order to a venue other than the Receiving Member for execution and the member directs just one order away from the Receiving Member, the member would be required to report OATS data for all of the orders entered into the Receiving Member's system.
- If the member relies on the Receiving Member, or a system provided by the Receiving Member, to determine where the order is routed for execution, the member will not be viewed as having direct control over subsequent routing or execution by the Receiving Member.

OATS Phase III – Reporting Member Exclusion

The receiving Reporting Member records and reports all information under the OATS Rules.

- The Reporting Member will be required to identify the sending member in each New Order Report and include a code indicating the sending member is a member that qualifies for exclusion from the definition of OATS Reporting Member under NASD Rule 6951(n).
- This code indicating the exclusion should be included in the Member Type Code Field on the New Order, Combined Order/Route and Combined Order/Execution Reports.

OATS Phase III – Reporting Member Exclusion

Have a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of the OATS Rules.

- All written documents evidencing the agreement must be maintained by each party to the agreement.
- NASD will be monitoring firms' use of this exclusion closely and may periodically request a copy of any reporting agreements as part of its routine OATS surveillance activities.

OATS Phase III – Exemptive Relief

NASD may grant exemptive relief from the OATS reporting requirements for manual orders to members that meet the following specified criteria:

- The member, current control affiliates and associated persons have not had a finalized disciplinary action within the last five years and within 10 years for fraud
- The member has annual revenue of less than \$2 million
- The member conducts no market making activities
- The member does not execute principal transactions with its customers
- The member does not conduct clearing or carrying activities

OATS Phase III – Exemptive Relief

- **In addition to meeting the previously outlined criteria, members must be able to demonstrate that transmitting data to NASD on a daily basis would be unduly burdensome.**
- **Exemptive relief is only available for the transmission requirements of the OATS Rules (NASD Rule 6955(a)). Firms that apply for and are granted exemptive relief must still record and maintain OATS information in an electronic format for a period of three years as required by NASD Rule 6954.**

UPDATE: On March 30, 2006, the SEC approved further amendments to the OATS Rules that expand NASD's OATS exemptive authority to include electronic recording requirements. As amended, NASD has the authority to grant exemptive relief from the OATS electronic recording and reporting requirements for manual orders to members that meet specified criteria.

OATS Phase III – Exemptive Relief

- Exemptions shall not exceed a period of two years. Members may request a subsequent exemption at or prior to the expiration of the initial exemption.
- NASD anticipates that exemptions may be granted for periods of less than two years depending on the facts and circumstances of each individual firm.
- Exemption requests must be submitted in writing to the NASD Market Regulation Department no later than February 1, 2006.
- Copies of all exemption requests must be submitted to NASD's Office of General Counsel.
- Detailed exemption request procedures, including a list of all required documentation, can be found on NASD's OATS website.

OATS Phase III – Other Technical Changes Coinciding with Phase III Release



New Special Handling Codes:

- **Directed Order (DIR)** will identify orders meeting the definition of “Directed Order” under Rule 600(b)(19) of Regulation NMS (formerly defined under SEC Rule 11Ac1-6). That definition specifies that the term directed order shall mean a customer order that the customer specifically instructed the broker-dealer to route to a particular venue for execution.
- **Time Order (TMO)** will identify an order that becomes a market or limit order at a specified time.

New Fields:

- All combined reports (Combined Order/Execution, Combined Order/Route) will now require the original shares quantity of the new order.
- Trigger timestamp field will be added for time orders on the New Order, Combined Order/Route, Combined Order/Execution and Cancel/Replace events.
- Routed Order ID and Sent to Routed Order ID must not contain blanks, spaces, delimiters or leading zeroes.

OATS Phase III – Transmission Methods

Firms required to submit data during Phase III may do so by using the following methods:

- **Internet File Transfer (IFT)** allows firms to upload data over the Internet. NASD highly recommends this alternative to all firms receiving more than a handful of orders.
- **E-mail** allows firms to send files via email. This alternative requires annual certification and User ID and password renewal.
- **File Transfer Protocol (FTP)** allows firms to submit data directly to NASD via a Savvis private network. Firms must contact Savvis directly to establish a network connection.

OATS Phase III – Transmission Methods

Firms required to submit data during Phase III may do so by using the following methods:

- **OATS Web Interface** allows firms to manually enter order data over the OATS Web Interface. NASD recommends this alternative to small firms receiving less than 10 orders per day.
- **Third Party Reporting Agent** allows firms with a reporting obligation to contract with clearing firms, service bureaus and other third party entities to transmit data on the firm's behalf. Firms must retain copy of the reporting agreement and create an Order Sending Organization (OSO) relationship via the OATS Web Interface.

OATS Phase III – Clock Synchronization

A Reminder:

NASD Rule 6953 requires each member to synchronize its business clocks that are used for purposes of recording the date and time of any event that must be recorded pursuant to the By-Laws or NASD Rules.

All computer system clocks and mechanical time stamping devices must be synchronized to within three seconds of the National Institute of Standards and Technology (NIST) atomic clock.

OATS Resources

The following resources are available to help members answer questions regarding OATS:

- www.nasd.com/oats
 - OATS Frequently Asked Questions
 - OATS Reporting Technical Specifications
 - OATS Subscriber Manual
 - OATS Report Index
 - OATS Registration Page
- OATS Helpdesk [1-800-321-NASD](tel:1-800-321-NASD)
- NASD Market Regulation [240-386-5126](tel:240-386-5126)